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July 7, 1997

BY HAND DELIVERY

William Caton
Office of the Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: Reply Comments of BellSouth Corporation in Support of Ameritech Michigan's Application for Provision of In-Region, InterLATA Services — CC Docket No. 97-137

Dear Mr. Caton:

Please find enclosed for filing the original together with twelve copies of BellSouth's Reply Comments in the above-captioned matter. We are also enclosing an electronic version in WordPerfect 5.1 format.

Please stamp and return the extra copy to the messenger.

Sincerely,

Michael K. Kellogg

Enclosures

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List A B C D E

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Michigan	CC Docket No. 97-137

To: The Commission

REPLY COMMENTS OF BELLSOUTH CORPORATION IN SUPPORT OF AMERITECH MICHIGAN'S APPLICATION FOR PROVISION OF IN-REGION, INTERLATA SERVICES

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July 7, 1997

EXECUTIVE SUMMARY

In opposing Ameritech's application to provide interLATA services in Michigan, the United States Department of Justice ("DOJ") has adopted a position contrary to one of the central goals of the Telecommunications Act — enhancing competition in long-distance markets. The DOJ gives little or no weight to the benefits of Ameritech's entry into long distance, but focuses instead on local market issues squarely within the jurisdiction of the Michigan Public Service Commission and the FCC. Thus, the DOJ has deprived this Commission of its antitrust expertise and exceeded its limited role under section 271.

The DOJ's conclusion that Ameritech must either lose a significant share of the local market or conduct full-scale, commercial trials would delay interLATA relief until Ameritech's competitors decide to compete seriously in local markets. This would undermine Congress's plan of opening all lines of business and letting the market determine when and how competition will develop. And it would maintain the perverse incentive that AT&T and other incumbent interexchange carriers have to avoid entering quickly as local carriers, in order to maintain barriers to entry into their own business. Finally, the DOJ's failure to set out a clear test for when it will support interLATA entry will further drag out the process of opening both local and long distance markets, again in contravention of legislative intent. While contrary to the Act, the DOJ's recommendation is consistent with past instances in which the DOJ has — in its efforts to dictate the development of telecommunications markets — advocated policies that stifle competition.

The DOJ's evaluation is not entitled to "substantial weight." This Commission owes no deference to an evaluation that falls outside the DOJ's area of expertise and that is so clearly at odds with Congress's pro-competitive and deregulatory design.

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Michigan	CC Docket No. 97-137

To: The Commission

REPLY COMMENTS OF BELLSOUTH CORPORATION IN SUPPORT OF AMERITECH MICHIGAN'S APPLICATION FOR PROVISION OF IN-REGION, INTERLATA SERVICES

BellSouth Corporation submits these Reply Comments in response to the United States Department of Justice's Evaluation of Ameritech's application for permission to provide in-region, interLATA services in Michigan. By seeking to micro-manage competition in Michigan, the DOJ has assumed for itself a role that Congress never intended it to play. Nor is the DOJ acting in the public's best interest within this self-assigned role. As explained in the accompanying affidavit of Professor Jerry Hausman of MIT, residential long-distance callers forego approximately $7 billion in competitive benefits each year that BOC long-distance entry is delayed. In effect, then, Section 271 imposes a regressive, yearly tax of $60 per household. The DOJ, however, seems absolutely determined to postpone these certain benefits of increased competition in long-distance markets.

The DOJ's Evaluation is flawed in several respects. First, the DOJ devotes virtually all its attention to examining Ameritech's compliance with checklist-related requirements. Such an

examination lies well outside the DOJ's expertise on antitrust matters and is beyond the modest role that Congress established for the DOJ. Second, the DOJ attempts to impose requirements beyond the checklist — which Congress expressly prohibited — by proposing a requirement that Ameritech demonstrate the openness of local telephone markets in Michigan through commercial trials and/or evidence that significant market share has been lost. These requirements delay beneficial competition by holding the BOCs hostage to the business strategies of local competitors. Finally, the DOJ attempts to control the timing and nature of competition in local and long-distance markets, ignoring Congress's intent that competition develop primarily through the operation of market forces and instead advances the anticompetitive agenda of the long distance incumbents.

This Commission owes no deference to an evaluation from the DOJ that is so fundamentally at odds with the Telecommunications Act.

DISCUSSION

1. In concluding that "Ameritech has not yet fully complied with all of the requirements of the competitive checklist,"[1] the DOJ has ventured far beyond its area of expertise. As BellSouth explained in its Reply Comments regarding SBC's Section 271 application for Oklahoma, it is the responsibility of this Commission, in consultation with state regulators, to determine whether an applicant "has fully implemented the competitive checklist in subsection (c)(2)(B)." 47 U.S.C.

[1]Evaluation of the United States Department of Justice, Application of Ameritech Michigan, CC Docket No. 91-137, at 44 (filed June 25, 1997) ("DOJ Evaluation").

§ 271(d)(3)(A). The DOJ's role under Section 271(d)(2)(A) is limited to analyzing the competitive impact BOC entry will have on the in-region, interLATA market.

Congress gave examples of the kinds of inquiries that the DOJ might appropriately pursue, such as whether a BOC's entry into the interLATA market would create a dangerous probability that it would successfully use market power substantially to impede competition in that market, or whether there is a substantial possibility that the BOC could use its power in the local market to impede competition in the interLATA market.[2] The Commission is to give "substantial weight" only to such evaluations grounded in the DOJ's expertise in antitrust matters.[3] Although the DOJ lobbied strenuously for veto power over BOC entry into long distance, Congress consistently rejected all attempts to expand the DOJ's authority in this area.[4]

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[2]Joint Explanatory Statement of the Committee of Conference, S. Conf. Rep. No. 104-230, at 149 (1996).

[3]See, e.g., 142 Cong. Rec. H1176 (statement of Rep. Jackson-Lee); 142 Cong. Rec. H1178 ("FCC's reliance on the Justice Department is limited to antitrust related matters") (statement of Rep. Sensenbrenner). As the Chairman of the House Judiciary Committee explained, section 271 provides that the "Department of Justice will apply any antitrust standard it considers appropriate . . ."; by requiring that the FCC give substantial weight to the views of the DOJ, "the conferees acknowledge the long experience and considerable expertise it has developed in this field. Under this approach, the FCC will have the benefit of a DOJ antitrust analysis before the Bell companies are allowed to enter the long distance market." 142 Cong. Rec. H1157 (statement of Rep. Hyde) (emphasis added).

[4]For example, the so-called Thurmond second-degree amendment, which would have required the Attorney General's approval before any BOC could provide in-region, interLATA service, see 141 Cong. Rec. S8145-46, was defeated precisely because it would have expanded the authority of the DOJ beyond the limited role to which it had been assigned. Just moments before the final vote on the Thurmond amendment, Senator Kerrey, who supported the amendment, presented the issue to his colleagues as follows: "[T]he choice before Members on the tabling motion will be: Trust the 14-point checklist, basically, that the committee has offered as an indication; or do we want, in a parallel process, the Department to make a determination as

With respect to the competitive impact that BOC entry into long distance will have on relevant markets, the DOJ's own expert economist identifies several "significant benefits" that could result, including (1) reductions in retailing costs enabled by joint provision of local and long-distance service; (2) offering consumers valuable new options (e.g., the convenience of "one-stop shopping"); and (3) increasing the degree of competition in long-distance services.[5] Thus, on the only matter as to which the Commission is to give the DOJ's view "substantial weight" — the impact that BOC entry will have on competition in relevant markets — the DOJ's own expert concludes that BOC entry would likely have beneficial competitive effects.

2. Rather than limiting itself to these issues, however, the DOJ has set itself up as an arbiter of the sufficiency of Sections 251 and 252 in opening local markets to competition. As a result of this detour, the DOJ suggests that the FCC should impose requirements that go far beyond the exclusive checklist criteria that Congress established, something the FCC is prohibited from doing under Section 271(d)(4). For example, in concluding that Ameritech has failed to demonstrate compliance with the checklist requirement of providing both unbundled switching and transport, the DOJ rests upon Ameritech's failure to complete testing that "AT&T's experts assert . . . is necessary."[6] The DOJ has effectively concluded that Ameritech is not in compliance

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to whether or not competition exists at the local level. That is all we are discussing and debating. I believe we want the Department of Justice to make that determination. I do not have the confidence in the 14-point checklist that others do. It is as simple as that." 141 Cong. Rec. S8224 (remarks of Sen. Kerrey). The amendment was defeated 57 to 43. Id. at S8225.

[5]Affidavit of Marius Schwartz ¶ 7 (May 14, 1997) (attached as Exhibit 1 to DOJ Evaluation).

[6]DOJ Evaluation at 21.

with the checklist until AT&T says so, just because the testing urged by AT&T may be "relevant" to assessing Ameritech's capabilities.[7]

Likewise, the DOJ now requires that the BOC demonstrate (for an unspecified period of time) "a track record of performance described by comprehensive measures" before its wholesale support processes will be deemed adequate to satisfy the checklist.[8] It is apparently not a sufficient indication of the viability of competition that Ameritech has already lost as many as 80,000 lines to competitors in Michigan.[9] Instead, the DOJ would require Ameritech to wait until its competitors are willing and able to engage in "carrier-to-carrier testing and/or commercial use" of its wholesale support processes, for a sustained and indefinite period of time, before receiving authority to enter the in-region, interLATA market.[10]

Like the "actual competition" tests explicitly rejected by Congress,[11] this requirement to put forward evidence derived from commercial use and/or carrier-to-carrier testing places checklist compliance beyond the BOCs' control. Where a BOC can otherwise show that checklist items are available to competitors, it is wrong to condition Section 271 relief on the results of

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[7] Id.

[8] Id. at A-3 to A-4.

[9] Id. at 32.

[10] Id. at A-8.

[11] See, e.g., 141 Cong. Rec. S8319, S8326 (June 14, 1995) (rejecting "Kerrey amendment," which would have conditioned long-distance entry on a BOC's having reached interconnection agreements with carriers "capable of providing a substantial number of business and residential customers" with service); 141 Cong. Rec. H8425, H8459-60 (Aug. 4, 1995) (passing "manager's amendment," which eliminated requirement that BOCs show they face actual local competition as condition for entry into long distance).

commercial trials. Such trials depend at least as much on the readiness and cooperation of the competitor — which are not checklist requirements and are beyond the BOC's control — as on the adequacy of the BOC's systems.

3. By incorporating a subjective determination of whether there is currently "enough" competition in the local exchange market into its standard for Section 271 relief, the DOJ risks delaying indefinitely the public interest benefits that will flow from BOC entry into long-distance markets. Chairman Hundt acknowledged recently that "the entry into the long distance market by [a BOC] would promote competition and benefit consumers."[12] The DOJ itself acknowledged that "InterLATA markets remain highly concentrated and imperfectly competitive, . . . and it is reasonable to conclude that additional entry, particularly by firms with the competitive assets of the BOCs, is likely to provide additional competitive benefits."[13]

Professor Jerry Hausman has quantified these benefits. He concludes, based on the experiences of the Southern New England Telephone Company and GTE, that entry by the BOCs into in-region long distance will very quickly lead to price reductions in the range of 17-18 percent for consumers of residential long-distance services. Nationally, these price reductions will yield direct consumer savings of approximately $6.2 billion per year (in 1996 dollars), as well as

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[12]Separate Statement of Chairman Reed E. Hundt, In the Matter of Application of SBC Communications Inc., Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in Oklahoma, CC Docket No. 97-121 (FCC June 25, 1997).

[13]Evaluation of the United States Department of Justice, In the Matter of Application by SBC Communications Inc., Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Oklahoma, CC Docket No. 97-121, at 3-4 (May 16, 1997).

an additional benefit of about $450 million due to additional calls residential consumers will make due to lower prices.[14] Based on these total benefits of nearly $7 billion annually, residential customers pay a Section 271 "tax" of over $60 per household per year.[15] They are about $10 billion worse off because interLATA relief has been delayed since passage of the 1996 Act. For every additional month of delay in granting interLATA relief, consumers lose another $550 million.

Instead of evaluating the costs and benefits of Ameritech's immediate entry into long-distance services in Michigan, the DOJ tries to orchestrate, by delaying interLATA relief, its preferred market outcome: large-scale entry into local markets before full interLATA competition. Toward that end, the DOJ focuses its attention on "the history of actual commercial entry" in Ameritech's local exchange markets and on whether there is currently "enough local competition in Michigan" to support immediate relief.[16] According to the DOJ, it is not "enough" that there are 22 competitive local exchange carriers that have been authorized to provide local service in Michigan; that there are at least 7 firms currently providing local service to business and/or residential subscribers (either through resale or on a facilities basis, or both); and that there are approximately 80,000 lines currently being served by competitive providers in Michigan.[17]

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[14]Statement of Professor Jerry A. Hausman ¶¶ 10-15 (attached).

[15]Id. ¶ 16.

[16]DOJ Evaluation at 30-31.

[17]Id. at 31-32.

Even extensive market-share loss might not be "enough" for the DOJ if it is not of the kind the DOJ deems appropriate. The DOJ now says that a threshold inquiry in its analysis is whether there is "broad-based commercial entry involving all three entry paths"[18] — i.e., construction of new networks, use of unbundled elements, and resale of BOC services — a requirement that might never be satisfied where, for example, state pricing policies encourage new entrants to rely on unbundled elements rather than resale or new construction.

Such micro-management of local competition is entirely at odds with the policy Congress adopted, whereby regulators would open telecommunications markets to competition and then stand back. The hallmark of the Telecommunications Act is the removal of barriers to entry in the local and interLATA telecommunications markets. Once these barriers are removed, Congress intended for market forces to determine when, how, and to what degree competition would actually develop.

The DOJ's approach is flawed procedurally, as well as substantively. In its evaluations of SBC's application for Oklahoma and Ameritech's application for Michigan, the DOJ has given only peeks at its standards for interLATA entry. Eighteen months after enactment of the 1996 Act, the DOJ still has not provided definitive standards for assessing BOC applications under section 271. That may be good theater, but it is bad policy. Putting aside the inconsistency of the DOJ's general approach with the Act, if the BOCs do not know what the DOJ's specific standards are, they cannot satisfy them. Long distance entry will be delayed, and so will the measures the DOJ wants to see in the local exchange.

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[18] Id. at 30.

The only beneficiaries of the DOJ's piecemeal approach are the long distance carriers. By protecting their current market share, these incumbents realize billions of dollars in extra profits each year.[19] At this time when its ability to compete in new businesses is being questioned, AT&T in particular is in no rush to endanger its lion's share of these profits by becoming a serious local carrier. The DOJ's case-by-case approach fits nicely with the delaying tactics of these competitors, but not with the Government's proper role of promoting competition and the interests of consumers.

4. This is not the first time the DOJ has, in trying to shape telecommunications markets, promoted the interests of AT&T rather than consumers; the history of its prior interventions should cause this Commission to review its latest attempt with particular skepticism.

As far back as 1913, the DOJ sanctioned AT&T's telephone monopolies through an agreement known as the "Kingsbury Commitment." Having devoured most of the independent telephone companies worth acquiring, AT&T was allowed to keep them on its promise not to acquire the rest. AT&T's local monopolies remained intact, and there was no provision for competition to the Bell System in connecting the local monopolies via intercity lines. Western Union was spun off from the Bell System, but only to provide telegraph service, not telephony.

The 1956 consent decree between the DOJ and AT&T is another example. After the DOJ brought an antitrust suit focusing mainly on AT&T's ownership and control of Western Electric's equipment operations, AT&T and the Department of Defense persuaded the Attorney General

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[19] See generally F. Duane Ackerman, Why is AT&T Afraid to Compete?, Wall Street Journal, July 3, 1997, at A10.

that "a way ought to be found to get rid of the case," and to limit remedies to "practices that [AT&T] might agree to have enjoined with no real injury to [their] business."[20] The settlement thus included neither the divestiture of Western Electric nor any other structural relief originally requested by the DOJ, but instead limited competition by holding AT&T to its core business of providing common carrier services.[21]

Years later, AT&T found this line-of-business restriction too restrictive, believing the regulated common carrier business would become so unprofitable, given the march of technology, as to render AT&T "a withering corporation waiting for its demise and nothing more."[22] Thus, in the Modification of Final Judgment ("MFJ"), AT&T pulled off its greatest trick. With the agreement of the DOJ, it spun off the BOCs and then agreed on the new companies' behalf to restrictions that prohibited them from competing against AT&T itself.[23]

Thereafter, the DOJ used its role as administrator of the MFJ's waiver process to limit or block competition from the BOCs (and to AT&T) in such markets as cellular services, information services, and out-of-region long distance. Even though AT&T acknowledged before

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[20]United States v. AT&T, 552 F. Supp. 131, 136-37 (D.D.C. 1982) (quoting Memorandum of T. B. Price (Mar. 3, 1954), reprinted in Report of the Antitrust Subcommittee of the House Committee on the Judiciary on the Consent Decree Program of the Department of Justice, 86th Cong., 1st Sess. 53-54 (Jan. 30, 1959)), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983).

[21]United States v. Western Elec. Co., 1956 Trade Cas. (CCH) ¶ 68,246 (D.N.J. 1956).

[22]United States v. AT&T, 1982-1 Trade Cas. (CCH) ¶ 64,645 at 72,607 (D.D.C. 1982).

[23]See United States v. AT&T, 552 F. Supp. 131.

divestiture that the MFJ's line-of-business restrictions were anticompetitive and unfair,[24] AT&T consistently opposed BOC interexchange and manufacturing relief after divestiture,[25] and, in many cases, the DOJ acquiesced. After briefly endorsing competition during the Triennial Review in 1987,[26] the DOJ thereafter largely backed the status quo. The DOJ even tried, through a deal with Ameritech in 1995, to use the waiver process to control the BOCs' intrastate operations.[27] As Representatives Dingell, Tauzin, Boucher, and Stupak explained in the House Report on the new Telecommunications Act, administration of the waiver process by the district court and the DOJ was marked by "an ossified perspective of an industry structure . . .; a lack of expertise and

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[24]AT&T stated that it was "against the restrictions" and that the BOCs should be free to "do what they want" following divestiture. Hearing Transcript at 25210, United States v. Western Elec. Co., No. 82-0192 (D.D.C. June 29, 1982) (argument of Howard J. Trienens); see Reply Comments of AT&T at 104, United States v. AT&T, No. 74-1698 (D.D.C. May 21, 1982).

[25]See, e.g., AT&T's Comments on the Report and Recommendations of the United States (D.D.C. Mar. 13, 1987); AT&T's Response to Comments on the Report and Recommendations of the United States (D.D.C. Apr. 27, 1987); AT&T's Motion for Declaratory Ruling on the Meaning of Manufacturing (D.D.C. June 19, 1987); AT&T's Opposition to RBOC's Motion to "Exempt" Wireless Services from Section II of the Decree (DOJ Apr. 27, 1992); AT&T's Further Opposition to RBOCs' Motion to Exempt "Wireless" Service from Section II of the Decree (DOJ May 3, 1993) (all filed with the district court or DOJ in United States v. Western Elec. Co., No. 82-0192 (D.D.C.)).

[26]See United States v. Western Elec. Co., 673 F. Supp. 525, 543 (D.D.C. 1987) (discussing DOJ position), aff'd in part and rev'd in part, 900 F.2d 283 (D.C. Cir.), cert. denied, 498 U.S. 911 (1990).

[27]Preliminary Memorandum of the United States in Support of Motion for Modification of the Decree to Permit a Trial, Supervised by the Department and the Court, in which Ameritech Could Provide Interexchange Service for a Limited Geographic Area, With Appropriate Safeguards, When Actual Competition and Substantial Opportunities for Additional Competition in Local Exchange Service Develop, United States v. Western Elec. Co., No. 82-0192 (D.D.C. filed Apr. 3, 1995).

understanding of the way telecommunications markets operate; and the lack of an orderly procedure to ensure that waiver requests are timely processed."[28]

The 1996 Act was intended to put a stop to the DOJ's intervention in telecommunications markets and return power over those markets to state and federal regulators. But, through its "fully and irreversibly opened to competition" standard, the DOJ again claims the power to block competition to AT&T. As long as the major interexchange carriers can delay significant entry into local telephone markets, the DOJ will recommend that they remain protected in their own market. That is flatly contrary to the public interest, because it would maintain barriers to competition in long distance even after the competitive checklist has been fully satisfied and local markets are open. By holding out for perfect competition at the local exchange level of telecommunications, the Justice Department would delay real competition at all levels.

CONCLUSION

For the foregoing reasons, and for the reasons discussed in its initial comments and in the comments of other parties supporting Ameritech's application, BellSouth urges the Commission to grant Ameritech's section 271 application.

[28]H.R. Rep. 104-204, pt. 1, at 207-08 (1995).

Respectfully submitted,

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Counsel for BellSouth Corporation

July 7, 1997

Declaration of Professor Jerry A. Hausman

1. I am MacDonald Professor of Economics at the Massachusetts Institute of Technology in Cambridge, Massachusetts, 02139.

2. I received an A.B. degree from Brown University and a B.Phil. and D. Phil. (Ph.D.) in Economics from Oxford University where I was a Marshall Scholar. My academic and research specialties are econometrics, the use of statistical models and techniques on economic data, and microeconomics, the study of consumer behavior and the behavior of firms. I teach a course in "Competition in Telecommunications" to graduate students in economics and business at MIT each year. Competition in long distance is one of the primary topics covered in the course. I was a member of the editorial board of the Rand (formerly the Bell) Journal of Economics for the past 13 years. The Rand Journal is the leading economics journal of applied microeconomics and regulation. In December 1985, I received the John Bates Clark Award of the American Economic Association for the most "significant contributions to economics" by an economist under forty years of age. I have received numerous other academic and economic society awards.

3. I have done significant amounts of research in the telecommunications industry. My first experience in this area was in 1969 when I studied the Alaskan telephone system for the Army Corps of Engineers. Since that time, I have studied the demand for local measured service, the demand for intrastate toll service, consumer demands for new types of telecommunications technologies, marginal costs of local service, costs and benefits of different types of local services, including the effect of higher access fees on consumer welfare, demand and prices in the cellular telephone industry, and consumer demands for new types of pricing options for long

distance service. I have also studied the effect of new entry on competition in paging markets, telecommunications equipment markets, and interexchange markets and have published a number of papers in academic journals and books about telecommunications. I have also edited two recent books on telecommunications, Future Competition in Telecommunications (Harvard Business School Press, 1989) and Globalization, Technology and Competition in Telecommunications (Harvard Business School Press, 1993).

4. I have previously provided affidavits to the FCC on competition among long distance providers. I submitted an affidavit to the FCC in November 1993 regarding competition for Basket 1 services in the long distance industry as part of the AT&T dominance proceeding. I also submitted affidavits in 1994 and 1995 on competition among long distance providers to the Department of Justice (DOJ) regarding the waiver request of the BOCs to provide cellular long distance and to provide landline long distance service. For this declaration I have updated my analysis by using newly available data from 1997. I have been asked by BellSouth to consider the question of what would the consumer benefits be from BOC entry into the residential long distance market.

I. Summary and Conclusions

5. BOC entry into long distance will lead to decreased prices and increased competition. BOCs have an economic incentive to offer lower prices than IXCs. Market evidence for landline long distance in Connecticut offered by SNET and by GTE elsewhere in the US, demonstrates that prices could well decrease by about 17-18%. Economic benefits to residential customers would be about $7 billion per year.

II. BOC Entry into Long Distance Will Lead to Lower Prices and Increased Competition

6. Most students of telecommunications agree that customers want some degree of one stop shopping. AT&T, MCI, and Sprint have all stated publicly that they believe it is important competitively to be able to offer one stop shopping. BOC entry into long distance will permit them to offer one stop shopping to compete with AT&T, MCI, Sprint, Time Warner, and other companies who have publicly announced their future strategy. Increased choices to consumers make them better off, so they will benefit from BOC entry into long distance. However, increased choices will not be the only consumer effect of BOC entry. Lower long distance prices and increased long distance competition will be the main benefit. In a market of about $67 billion per year, price decreases will create consumer benefits in the billions of dollar per year. Furthermore, market evidence which I will discuss below demonstrates that long distance prices have decreased in landline long distance in Connecticut where SNET has been permitted to provide competition to the IXCs and in California and other states where GTE has been permitted to provide competition to the IXCs.

A. Economic Theory Demonstrates that BOCs Have an Economic Incentive to Decrease Long Distance Prices

7. Economic theory demonstrates quite clearly that BOCs have an economic incentive to decrease long distance prices. First, BOCs will have economies of scope which will lead to lower costs and lower prices. More importantly, because (under current regulatory policies) access and long distance are both sold at prices well above marginal (incremental) cost to cover the large fixed costs of the local and long distance networks, the "double marginalization" effect will give the BOCs an economic incentive to lower prices. When two companies are in a vertical relationship, the upstream company sets its margin to maximize its profits individually while the downstream company does the same. If the upstream company begins to offer the downstream product also, it generally will set the final price of the

downstream product to maximize its profits jointly. The company offering the combined product will often find it profitable to lower the price of the final product. This price decreasing effect has been recognized by economists for decades. While access reform under the 1996 Act has decreased the access margin, it has not eliminated the entire margin. Thus, the price decreasing effect of BOC entry into long distance will remain.[1]

8. Suppose the BOC incremental margin on access is $0.03 per minute while the IXC incremental margin is at least $0.07 per minute on residential long distance calls. The BOC would find it to be profit maximizing to lower the total margin from $0.10 per minute because it earns both margins, rather than only a single margin. Thus, when a BOC sells a minute of long distance, it earns a total of $0.10 in total margin, compared to only $0.07 margin for an IXC.[2] When the BOC decreases the price slightly, it sells more access and more long distance and earns approximately $0.10 per minute, while if an IXC decreases the price it only receive the additional margin from increased long distance of $0.07. Thus, the BOC has a greater incentive to charge lower long distance prices than an IXC. Furthermore, when the BOC lowers the long distance price, the IXCs will lower their prices, which will create increased demand and more access minutes for the BOCs.

9. Using a long distance elasticity estimate of -0.723 and an economic model of AT&T price leadership in residential long distance, I compute that BOC entry will lead to decreased long distance price of at least 15-25%.[3] The

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[1] Although BOC entry may harm some inefficient IXCs, the public interest concerns protection of competition, not inefficient competitors. Also, note that under Sections 251 and 252 of the 1996 Act, IXCs will have the ability to provide facilities based access, which will allow them to realize both margins similar to the BOCs.

[2] Note that the BOC would also be using two sets of facilities, local access and long distance facilities, to earn this higher margin.

[3] If I let the long distance margin be higher which is likely to be the actual situation, I would estimate a larger expected decrease in long distance prices. The market price elasticity that I use is widely accepted in the economics literature. See e.g. W. Taylor and L. Taylor, American Economic

long distance price elasticity predicts the percentage increase in long distance calls for a 1% decrease in long distance prices, and the calculation finds that the BOCs have a significant economic incentive to lower prices because of the significant increase in long distance traffic. Thus, economic analysis predicts that BOC entry creates an incentive for BOCs to decrease long distance prices and increase long distance competition. Consumers would benefit from this outcome.

B. Long Distance Price Data

10. BOC entry into long distance will almost surely lead to price decreases for consumers, especially residential customers. Decreased prices should be the basis for a public interest determination regarding BOC entry since consumers always benefit from decreased prices for a product or service (holding quality constant). AT&T has claimed numerous times that the reason that it has continued to increase Basket 1 prices was that the FCC set these prices too low. Indeed, AT&T's economists, Prof. Willig and Prof. Bernheim stated that the fact that Basket 1 prices were too low was their "central observation" in an affidavit filed with the Department of Justice regarding BOC entry into long distance. (Affidavit of Prof. R. Willig and D. Bernheim, 1995, p. 138). To the extent that BOCS are permitted to enter the market, prices will decrease because the BOCs will start with a 0% share and be forced to attract customers away from AT&T, MCI, Sprint, and other IXCs. Customers will be made better off by the decreased prices and increased competition.

11. An example of consumer benefits and increased competition from LEC entry into long distance is Southern New England Telephone Company (SNET). SNET was part of the old AT&T system, but because of an historical quirk, SNET was not covered by the MFJ. SNET provides local telephone service to all of Connecticut (except for Greenwich). Thus, SNET is in a similar position to a BOC, for instance BellSouth in Georgia. SNET has been allowed to provide

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Review, 1993, and the value of the elasticity is consistent with past regulatory filings by AT&T.

interLATA long distance service, and has offered attractive price plans. SNET is reported to have gained about a 25%-30% share of long distance business in Connecticut. To compare SNET's prices to AT&T's, I gathered data during early January 1997 on SNET's long distance prices.[4] Using a typically pattern for residential customers, I estimated that SNET's prices were 24.0% lower than AT&T for a customer who did not qualify for an AT&T discount plan and 10.6% less for customers who qualified for an AT&T discount. Using the estimated number of AT&T customers on a discount plan, I find that overall SNET residential prices are about 18.4% less that AT&T's prices on average.[5]

12. To do some direct comparisons, SNET's peak period (no discount) interstate price was $0.23 per minute while AT&T's was $0.31 per minute, a difference of 34.8%. Since SNET does not bill in full minute increments the actual difference will be even larger. For an average user who qualifies for a discount, SNET's price decreases to $.20 per minute while AT&T decreases to $.233 per minute, for a difference of 15.5%. Similar differences exist for shoulder and offpeak periods, although SNET charges a uniform rate for both shoulder (5-11 PM) and offpeak of $.13 per minute, while AT&T charges $.19 per minute for shoulder and $.16 per minute for offpeak, both significantly above SNET's rates. Thus, while the per minute average will differ depending on the exact calling pattern for a particular residential user, SNET's rates were significantly below AT&T's rates in Connecticut.

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[4] SNET had both lower prices than AT&T and a longer offpeak period, both of which lead to savings for consumers.

[5] This comparison of AT&T and SNET does not account for the recent price changes enacted on July 1, 1997 by AT&T due to their promise to the FCC to lower residential long distance prices when access rates were decreased. However, I expect a similar relationship of SNET undercutting AT&T prices to persist in the future.

C. Gains in Consumer Welfare from Decreased Long Distance Prices

13. On a national basis, if competition had the same effect as in Connecticut, the benefits to residential long distance customers can be calculated using a well known economic approach.

Change in Consumer Welfare from Lower Long Distance Prices

$$\Delta W \approx \sum_{i=1}^{m} -\Delta p_i \, (q_i + .5\Delta q_i)$$

$$\approx \sum_{i=1}^{m} -\frac{\Delta p_i}{p_i} \, [p_i q_i + .5\eta_i \left(\frac{\Delta p_i}{p_i}\right)(p_i q_i)] \qquad (1)$$

where: q_i = *quantity*

p_i = *price*

η_i = *price elasticity*

$\Delta p_i / p_i$ = *percentage change in price*

The first term in the formula is the percentage price change times the size of the residential long distance market. I use the SNET prices to estimate the consumer savings which are approximately $6.2 billion per year. Thus, the direct savings to residential long distance customers would total about $6.2 billion per year. The second term in the equation arises from increased consumer welfare from making more long distance calls because of the lower prices. Here, I need an estimate of the price elasticity so that I use -0.723 which is the estimate found in the academic literature (e.g. Taylor and Taylor (1993)) for interLATA calls and is the magnitude used by AT&T in past regulatory filings with the Commission. This terms leads to another $451 million in increased consumer welfare that would arise from additional calls that customers would place because of the lower rates. Thus, the total increase in consumer welfare using 1996 values is $6.7 billion which using likely 1997 values would exceed $7 billion. Thus, overall residential

consumers would gain about $7 billion in consumer welfare. Additional gains would also go to businesses because of the increased competition.

14. No better evidence of the public interest benefit of BOC entry into long distance can exist than SNET's role in bringing lower prices to Connecticut consumers. AT&T has responded by lowering its prices as well which demonstrates increased competition. Note that AT&T is not claiming that SNET has distorted competition through cross subsidy or through discrimination. SNET has simply offered lower prices. Increased competition from new entry leads to lower prices. Consumers benefit from lower prices and increased competition.

15. Another example of a large LEC which provides interstate long distance service is GTE.[6] GTE began providing long distance telephone service in areas in which GTE provides local exchange service in March 1996. GTE charges lower rates that AT&T for both interstate and intrastate calls. GTE's discount plan, Easy Savings, has the same terms as AT&T's largest discount plan, True Reach Savings, so that the comparison of prices is straightforward between GTE and AT&T and their discount plans.[7] GTE's prices are 17.2% lower than AT&T's prices for residential customers.[8] Thus, both GTE and SNET are offering customers substantial discounts in the range of 17-18%. Increasing consumers saving and increased economic efficiency would again be in the $7 billion range if based on GTE's prices, similar to the calculations based on SNET's prices.

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[6] GTE is approximately equal to an average size BOC in terms of either total access lines or total revenue.

[7] GTE gives an additional 10% discount for the first year of service. I do not take account of this additional discount in the calculation.

[8] AT&T has begun an advertising campaign which claims that GTE's service and network in unreliable. GTE has sued AT&T for false and misleading advertising.